



The Pizza inn inc.
1972 ANNUAL REPORT

CLEVELAND PUBLIC LIBRARY
BUSINESS INF. BUR.
CORPORATION FILE

BLACK OLIVE
PEPPERONI
CHEESE

Management

F. J. Spillman*
Chairman of the Board, President
and Chief Executive Officer

John W. Tenery*
Executive Vice President

Larry G. Hood
Vice President — Finance

Raymond E. Kelly
Vice President — Administration

Lyle B. Clothier
Vice President — Marketing

M. R. MaGouirk
Vice President — Operations

George W. Wragg
Vice President — Distribution

Stephen F. Newton
Secretary and Corporate Counsel

James A. Rozzell
Controller

John A. Spillman*

Roy L. Wise, Sr.*

**Director*

Corporate Headquarters
The Pizza Inn, Inc.
2930 N. Stemmons Freeway
Dallas, Texas 75247

Transfer Agent and Registrar
National Bank of Commerce
1525 Elm Street
Dallas, Texas 75201

Corporate Attorney
Wynne Jaffe & Tinsley
LTV Tower
Dallas, Texas 75201

Auditors
Ernst & Ernst
600 Fort Worth National Bank Bldg.
Fort Worth, Texas 76102



Management
Officers and Board of Directors
Seated and reading clockwise are:
Stephen F. Newton, M. R. MaGouirk,
George W. Wragg, Roy L. Wise, Sr.,
F. J. Spillman, John A. Spillman,
John W. Tenery, Lyle B. Clothier and
Raymond E. Kelly. Standing:
Larry G. Hood at left and
James A. Rozzell

To Our Shareholders:

For 1972, your Company reached an all-time high by establishing new records for gross revenues totaling \$14,601,000 and net income of \$802,708, or equal to 54¢ per share. This was the direct result of a unified team effort by all members of management. Additions to this team during 1972 include the election of Lyle B. Clothier to the position of Vice President — Marketing and James A. Rozzell to the position of Controller. Messrs. Clothier and Rozzell have been associated with the Company since January, 1972 and November, 1968, respectively.

In 1972, operating with fewer units, gross revenues increased by 22.3%. This is attributable to the volume increase achieved in the remaining stores and more stringent controls of store operations by eliminating one level of field supervision and having the supervisors responsible only to directives of the home office.

The Company's past-due financial obligation, relating to a 1971 agreement with unsecured creditors, was paid in full in December, 1972. This was six months ahead of the settlement date as set forth in the original agreement.

Management's objective for 1972 was to build a solid financial base from which Pizza Inn could resume expansion of its operations. Expansion was curtailed during 1972 with only four Company operated units being added. At the same time, however, expansion activity among our franchisees increased, with twenty-seven

new units being completed during the year.

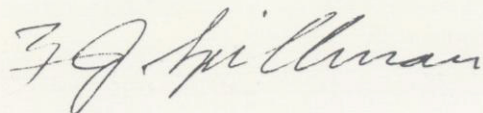
Your management feels it has accomplished the goal set for 1972. Subsequent to year end, two additional Company-operated units were added and thirty-three additional units are planned for opening in 1973. At this time, the franchised operators have sixty additional units either under construction or in lease negotiations.

The Company's franchising operations were expanded internationally during early 1973 with the opening of the first Pizza Inn in Japan. The second unit is expected to open in April, with approximately ten units targeted for Japan by the end of the year.

The volume increase obtained during 1972 is expected to continue throughout 1973. As fixed costs remain constant, this will enable your Company to earn more per unit during the ensuing year. Additional volume is anticipated from new food items incorporated on the menu during the year.

After achieving record results during 1972, your management is dedicated to surpassing this record during 1973.

Respectfully,

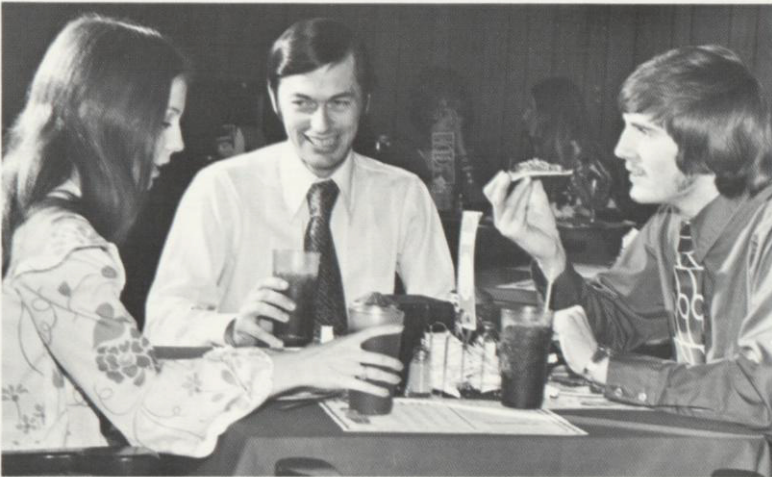


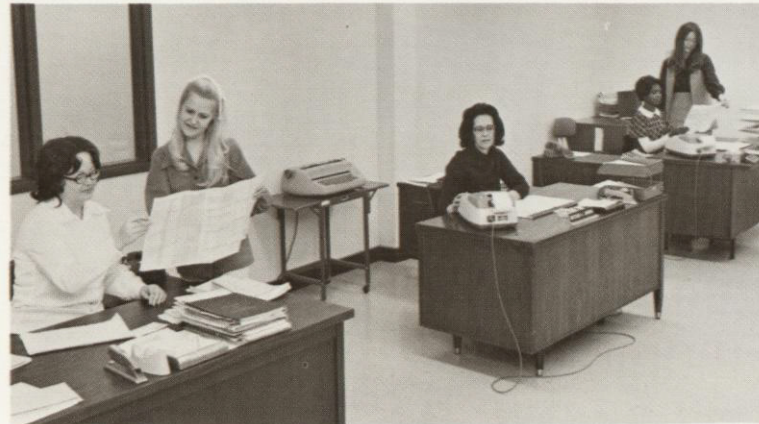
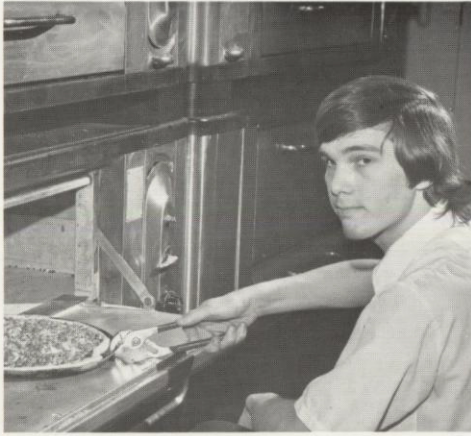
President

March 21, 1973



Our Customers
The accompanying photos
are representative of
typical customers at
Pizza Inns.





Our People
 Shown on these pages
 are various scenes
 depicting our restaurant
 and corporate personnel.



Norco Manufacturing and Distributing Company, the warehousing and distribution division of The Pizza Inn, Inc., is located in the Great Southwest Industrial District in Arlington, Texas. This warehousing facility distributes over 300 food, paper and equipment items to 275 Pizza Inns located in twenty-eight states.

Through this centralized purchasing and warehousing division, better quality control can be obtained, thus enabling Pizza Inn to utilize its mass purchasing power which results in lower food cost.

Norco's physical plant consists of 25,000 square feet of warehouse space and an office area utilizing 3,000 square feet. All items are palletized and handled through the use of a fork lift, which expedites handling of all incoming and outgoing merchandise.

The trucking operation enables Norco to make direct delivery to 75% of all Company owned and

twenty franchise stores located in Texas, Oklahoma, Kansas and Louisiana. With the current expansion program underway it is apparent that Norco will service the states of Missouri, Tennessee and Georgia before year end.

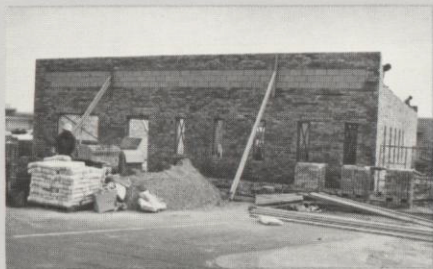
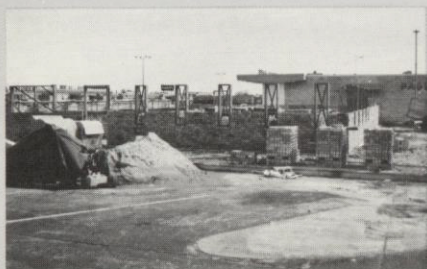
Norco's sales for 1972 were \$2,906,000, which represents a 40% increase over 1971 sales. Concentrated efforts are being made to encourage franchisees to purchase all items through the Norco Division by using a nominal percentage of markup on all items. This will generate additional purchasing power from which the entire Pizza Inn chain will benefit.

The Norco team is made up of nine dedicated employees interested in servicing its customers at the very lowest possible cost without jeopardizing either quality or service.



Expansion

The newest Pizza Inn Restaurant in Northeast Dallas is pictured during various stages of construction. January 20, foundation poured; February 10, walls going up and brickwork finished on February 14. Building nears completion as this report goes to press.



Consolidated Statement of Operations

	Year Ended December 31	
	1972	1971
Net sales	\$ 13,874,984	\$ 11,377,730
Cost of goods sold	10,161,342	9,839,719
	<u>3,713,642</u>	<u>1,538,011</u>
Monthly franchise royalties	462,622	281,815
Initial franchise fees	28,250	78,750
Other operating income	<u>202,781</u>	<u>169,970</u>
	4,407,295	2,068,546
Selling, administrative, and general expenses	<u>3,148,558</u>	<u>2,067,299</u>
	1,258,737	1,247
Interest income	<u>32,553</u>	<u>10,978</u>
	1,291,290	12,225
Interest expense — principally on long-term debt	<u>198,082</u>	<u>273,336</u>
Earnings (Loss) Before Income Taxes and Extraordinary Items	1,093,208	(261,111)
Income taxes:		
Currently payable	624,000	—
Deferred (credit)	<u>(118,500)</u>	<u>—</u>
	505,500	—
Earnings (Loss) Before Extraordinary Items	587,708	(261,111)
Extraordinary items — Note F	<u>215,000</u>	<u>(235,844)</u>
Net Earnings (Loss)	<u>\$ 802,708</u>	<u>\$ (496,955)</u>
Per share — Note A:		
Earnings (loss) before extraordinary items	\$.40	\$ (.18)
Extraordinary items	.14	(.17)
Net earnings (loss)	.54	(.35)

See notes to consolidated financial statements.

Consolidated Balance Sheet

	December 31 1972	December 31 1971
Assets		
Current Assets		
Cash	\$ 716,645	\$ 95,384
Receivables:		
Trade accounts	106,144	134,445
Equipment contract installments less unearned discounts (1972 — \$14,445; 1971 — \$28,880) — Notes D and G	165,542	229,025
Allowance for doubtful accounts (deduction)	(20,000)	(112,158)
	<u>251,686</u>	<u>251,312</u>
Deferred income taxes	118,500	—
Recoverable income taxes	—	38,961
Inventories	361,808	282,447
Property held for resale	266,649	1,051,771
Prepaid expenses	<u>34,612</u>	<u>38,998</u>
Total Current Assets	1,749,900	1,758,873
Other Assets		
Due from officers and directors	26,663	41,950
Equipment contract installments due after one year less earned discounts (1972 — \$72,402; 1971 — \$89,082) — Notes D and G	178,555	359,750
Lease and utility deposits and other	<u>98,463</u>	<u>136,761</u>
	303,681	538,461
Property and Equipment — Note D		
Land (1972 — \$683,906; 1971 — \$308,775) and buildings	1,871,685	950,923
Leasehold improvements	467,697	454,179
Fixtures and equipment	2,260,086	2,089,849
Allowances for depreciation (deduction)	<u>(912,174)</u>	<u>(580,359)</u>
	3,687,294	2,914,592
Intangibles — Note C		
	<u>1,360,283</u>	<u>1,318,078</u>
	<u>\$ 7,101,158</u>	<u>\$ 6,530,004</u>

Liabilities and Stockholders' Equity	December 31 1972	December 31 1971
Current Liabilities		
Notes payable to bank	\$ —	\$ 113,603
Trade accounts payable	336,663	470,450
Accrued compensation and related taxes	229,070	176,473
Other accrued expenses	489,178	499,977
Federal and state income taxes	378,000	—
Current maturities of long-term debt less related deferred interest (1972 — \$102,191; 1971 — \$111,464)	362,631	1,009,281
Total Current Liabilities	1,795,542	2,269,784
Long-Term Debt — less related deferred interest (1972 — \$83,618; 1971 — \$181,066) and current maturities — Note D	935,374	788,102
Deferred Income	134,851	148,810
Stockholders' Equity — Note E		
Common Stock — par value \$1 a share:		
Authorized — 5,000,000 shares		
Issued: 1972 — 1,455,393 shares;		
1971 — 1,521,765 shares		
(including 93,550 shares held in treasury)	1,455,393	1,521,765
Additional paid-in capital	2,583,924	2,647,702
Retained earnings (deficit)	196,074	(606,634)
Cost of Common Stock in treasury (deduction)	—	(239,525)
	<u>4,235,391</u>	<u>3,323,308</u>
Commitments and Contingent Liabilities — Notes H and I		
	<u>\$ 7,101,158</u>	<u>\$ 6,530,004</u>

See notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

	Year Ended December 31	
	1972	1971
Source of Funds		
From operations:		
Earnings (loss) before extraordinary items	\$ 587,708	\$ (261,111)
Charges (credits) to operations not requiring current outlays (receipts) of working capital:		
Depreciation	313,756	341,093
Amortization	32,691	1,517
Increase (decrease) in deferred income	(13,959)	36,634
Total from operations before extraordinary items	920,196	118,133
Extraordinary items	215,000	(235,844)
Total From Operations	1,135,196	(117,711)
Reduction in amounts due from officers	15,287	184,770
Decrease in other assets (net)	219,493	129,554
Decrease in intangibles	—	376,894
Proceeds from long-term borrowing less refinancing of \$97,000 in 1972	528,000	499,500
Issuance of Common Stock	109,375	—
	<u>\$ 2,007,351</u>	<u>\$ 1,073,007</u>
Application of Funds		
Business purchased in 1972:		
Property acquired at fair value	\$ 80,752	\$ —
Goodwill	74,896	—
Long-term debt assumed	(132,148)	—
	<u>23,500</u>	<u>—</u>
Additions to property, plant and equipment less carrying value of assets sold or retired (1972 — \$91,764; 1971 — \$1,173,563)	1,005,706	(111,839)
Reductions of long-term debt	512,876	687,335
Acquisition of Common Stock in treasury	—	3,200
Increase in working capital	465,269	494,311
	<u>\$ 2,007,351</u>	<u>\$ 1,073,007</u>
Changes in Working Capital		
Decrease (increase) in current assets:		
Cash	\$ (621,261)	\$ 404,345
Receivables	(374)	4,969
Deferred income taxes	(118,500)	—
Recoverable income taxes	38,961	51,039
Inventories	(79,361)	470,094
Property held for resale	785,122	135,461
Prepaid expenses	4,386	121,763
	<u>8,973</u>	<u>1,187,671</u>
Decrease (increase) in current liabilities:		
Notes payable	113,603	177,221
Trade accounts payable	133,787	823,892
Accrued liabilities	(41,798)	334,550
Federal and state income taxes	(378,000)	—
Current maturities of long-term debt	646,650	346,319
	<u>474,242</u>	<u>1,681,982</u>
Increase in Working Capital	\$ 465,269	\$ 494,311

See notes to consolidated financial statements.

Consolidated Statement of Changes in Stockholders' Equity

Common Stock		
Balance at beginning of year	\$ 1,521,765	\$ 1,521,765
Cancellation of Common Stock in treasury	(66,372)	—
Balance at End of Year	<u>\$ 1,455,393</u>	<u>\$ 1,521,765</u>
Additional Paid-In Capital		
Balance at beginning of year	\$ 2,647,702	\$ 2,647,702
Issuance of Common Stock in treasury upon exercise of stock options and related tax benefit — Note E	22,735	—
Issuance of Common Stock in treasury for acquisition — Note B	12,804	—
Issuance of Common Stock in treasury in settlement of indebtedness	4,260	—
Cancellation of Common Stock in treasury	(103,577)	—
Balance at End of Year	<u>\$ 2,583,924</u>	<u>\$ 2,647,702</u>
Retained Earnings (Deficit)		
Balance at beginning of year	\$ (606,634)	\$ (109,679)
Net earnings (loss)	802,708	(496,955)
Balance at End of Year	<u>\$ 196,074</u>	<u>\$ (606,634)</u>
Common Stock in Treasury		
Balance at beginning of year	\$ 239,525	\$ 236,325
Exercise of certain stock options (19,000 shares) — Note E	(48,640)	—
Issued for acquisition (4,178 shares) — Note B	(10,696)	—
Payment of certain indebtedness (4,000 shares)	(10,240)	—
Sale of certain operating locations for Common Stock (1,575 shares)	—	3,200
Cancellation (66,372 shares)	(169,949)	—
Balance at End of Year	<u>\$ —</u>	<u>\$ 239,525</u>

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements December 31, 1972 and 1971

Note A — Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. Significant intercompany accounts and transactions have been eliminated.

The financial statements of a Mexican subsidiary (see Note B) have been translated at the exchange rate at year end which was the same as that at date of acquisition.

Inventories

Inventories, consisting of food, paper products, supplies, and equipment, are stated at the lower of cost (principally first-in, first-out method) or market.

Property and Equipment and Depreciation

Property and equipment are stated on the basis of cost. Additions, renewals, and betterments of property and equipment, except for relatively minor amounts, are capitalized; expenditures for maintenance and repairs are charged to operations. The cost of property and equipment sold or retired and the related accumulated depreciation are removed from the appropriate asset and depreciation account, and the resulting gain or loss is included in operations.

Provision for depreciation of property and equipment is computed using the straightline method. A summary of the ranges of the estimated useful lives of property and equipment on which depreciation is based follows:

Buildings	20 to 30 years
Leasehold improvements	10 years (lease term if less)
Fixtures and equipment	3 to 10 years

Intangibles

Costs of reacquired rights to sell Pizza Inn franchises and costs in excess of net assets of businesses acquired prior to November 1970 are not being amortized as, in the opinion of management, there has been no decrease in value.

Costs assigned to franchise territorial rights retained at the time of sale of certain operating locations in 1971 and costs in excess of net assets of a business purchased in 1972 are being amortized over twelve years and seven years, respectively.

See Note C for a summary of the intangible assets.

Franchise Fees and Royalties

Initial franchise fees, net of related commissions, are included in income when (1) such fees have been fully collected and the related restaurants have opened for business or (2) the franchises have expired and the franchisees have forfeited their fees and related rights. Royalties are accrued monthly based on sales by franchisees.

Promotional Coupons

Discounts arising from redemption of promotional discount coupons are included in selling, general, and administrative expenses.

Income Taxes

Deferred income taxes are provided for timing differences between financial and tax reporting; such deferred taxes relate principally to estimated expenses which have been provided for settlement of pending claims, litigation, and commitments.

Investment tax credits are taken into income as a reduction of the provision for federal income taxes during the year in which such credits become available.

Earnings Per Share

Earnings (loss) per common and common equivalent share are based on the weighted average number of common shares and common equivalent shares outstanding during the years (1972 — 1,487,498 shares; 1971 — 1,428,336 shares). Common equivalent shares include those issuable on the exercise of dilutive stock options and stock purchase warrants (after reduction for common shares assumed to have been purchased with the proceeds).

Reclassification of Certain 1971 Amounts

Certain amounts for 1971 have been reclassified to conform with 1972 reporting classifications.

Note B — Acquisition

As of May 1, 1972, the Company acquired Excalibur, S.A. De C.V., a Mexican corporation, which operates a Papa's Pizza Parlor in Monterrey, for 4,178 shares of Common Stock (aggregate value of \$23,500). The transaction has been accounted for as a purchase, and the relatively insignificant results of operations of the acquired company since acquisition date are included in the consolidated financial statements.

The cost of the acquired company over net assets acquired has been included in intangibles in the consolidated balance sheet and is being amortized over seven years which is the remaining term of the related real estate lease.

Note C — Intangibles

A summary of intangible assets follows:

	1972	1971
Reacquired sole and exclusive rights to sell Pizza Inn franchises	\$ 998,000	\$ 998,000
Franchise territorial rights retained in connection with the sale of certain operating locations during 1971 — unamortized portion	265,000	289,000
Excess of cost over fair value of net assets purchased — unamortized portion	97,283	31,078
	<u>\$1,360,283</u>	<u>\$1,318,078</u>

Amortization of intangible assets charged to operations during 1972 and 1971 was \$32,691 and \$1,517, respectively.

Note D — Long-Term Debt

A summary of long-term debt follows:

	1972	1971
Deed of Trust Notes, 7% to 10%, payable in monthly installments of \$8,935, with land and buildings carried at \$1,486,152 mortgaged at December 31, 1972	\$ 807,132	\$ 374,788
Equipment notes, 6% to 12%, payable monthly (generally over five years) collateralized by security agreements covering a major portion of equipment and pledge of equipment contract installments	490,873	1,319,022
Deferred trade payables — See Note J	—	103,573
	<u>1,298,005</u>	<u>1,797,383</u>
Less current maturities classified as current liabilities	362,631	1,009,281
	<u>\$ 935,374</u>	<u>\$ 788,102</u>

Maturities of long-term debt for the succeeding five years are as follows:

1973 —	\$362,631
1974 —	169,337
1975 —	132,975
1976 —	69,394
1977 —	56,741

Note E — Stock Options and Stock Purchase Warrants

Stock option plans, both qualified and non-qualified, for officers and key employees and an option, for 5,000 shares, granted in connection with an acquisition, provide for such options to be exercisable at market prices at dates of grant over a period of five years therefrom. At December 31, 1972, there were Common Stock options outstanding on 95,550 shares at prices ranging from \$1.35 to \$9.00 a share, as follows:

	No. of Shares	Option Price Per Share
Qualified Plan	32,850	\$2.125 to \$9.00
Non-Qualified Plan	62,700	1.350 to 9.00
	<u>95,550</u>	

All options granted under the non-qualified plan and options for 1,500 shares under the qualified plan were exercisable at December 31, 1972.

Non-qualified stock options on 22,500 shares were exercised or cancelled during the year, as follows:

	No. of Shares	Option Price Per Share
Exercised	19,000	\$2.125
Cancelled	3,500	2.125
	<u>22,500</u>	

In connection with a loan obtained from a bank in December 1972, a Common Stock Purchase Warrant for 20,000 shares of Common Stock at \$8.25 a share was issued to the bank. The Warrant is exercisable in whole or in part until its expiration in December 1984.

See Note H with regard to a Common Stock Purchase Warrant issued to Underwriters in connection with a public offering in 1969.

At December 31, 1972, a total of 202,700 shares were reserved for stock option plans and outstanding warrants.

Note F — Extraordinary Items

As a result of its 1971 and 1970 operations, the Company had ordinary operating loss carryforwards of approximately \$368,000 and investment credit carryforwards of approximately \$39,000; these carryforwards were used in full in 1972. The resulting reduction in income taxes of \$215,000 is shown as a 1972 extraordinary item.

During 1971, the Company sold 34 operating restaurants and a sausage plant. Such sales resulted in a loss of \$235,844; this amount is shown as a 1971 extraordinary item.

Note G — Due From Officers and Directors

Equipment contracts receivable include \$153,954 due from certain officers and directors. Such indebtedness results primarily from the sale of nine operating restaurants to those individuals in 1970 and 1971.

Note H — Commitments

Substantially all of the real property occupied by the Company is leased for terms ranging up to 20 years. Based on leases in effect at December 31, 1972, annual lease payments for restaurants, warehouses, and offices will be approximately \$1,100,000 (including \$50,000 applicable to closed operations) during the years 1973 through 1977; the total aggregate lease commitment amounts to approximately \$14,500,000 (including \$900,000 applicable to closed operations). With respect to closed operations, the Company attempts to renegotiate lease terms or sublease the properties where possible; however, in many instances, these are short-term arrangements which do not run for the entire lease term.

In connection with a public offering in 1969, a Common Stock Purchase Warrant for 20,000 shares of Common Stock at \$10.80 a share was issued to the Underwriters. The Company agreed that it would file, at its cost, a post-effective amendment to the Registration Statement covering the shares of Common Stock issuable upon exercise of the Warrant which will expire in 1974.

Note I — Contingent Liabilities

In connection with certain sales of equipment to franchisees, the Company is contingently liable to various financing institutions as the guarantor of franchisees' obligations. At December 31, 1972, such contingent obligation amounted to approximately \$40,500. The Company has also guaranteed the realty lease obligations of certain franchisees and remains contingently liable on the realty leases of certain operating restaurants which have been sold; related aggregate rentals amount to \$520,000 annually and amount to a total aggregate commitment of approximately \$8,500,000 at December 31, 1972.

Lawsuits pending or threatened against the Company at December 31, 1972, involved aggregate alleged damages of approximately \$585,000. The Company's legal counsel and management believe the suits comprising most of this amount to be without merit or grossly inflated and believe the maximum potential losses will not exceed \$100,000. Provision for such expected losses has been made in the consolidated financial statements at December 31, 1972.

Note J — Arrangement With Creditors

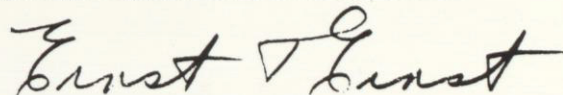
During 1971, the Company experienced a liquidity crisis and entered into an agreement with participating creditors whereby the Company would be extended additional time for the payment of certain trade payables. All payments were made as scheduled, or in advance, with the final payment having been made in December 1972; the Company has no further liability under the terms of the agreement.

Accountants' Report

Board of Directors
The Pizza Inn, Inc.
Dallas, Texas

We have examined the consolidated balance sheet of The Pizza Inn, Inc. and subsidiaries as of December 31, 1972 and 1971, and the related consolidated statements of operations, changes in stockholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of operations, changes in stockholders' equity, and changes in financial position present fairly the consolidated financial position of The Pizza Inn, Inc. and subsidiaries at December 31, 1972 and 1971, and the consolidated results of their operations, changes in stockholders' equity, and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.



Fort Worth, Texas
February 9, 1973



The Pizza Inn, Inc. 2930 N. Stemmons Freeway Dallas, Texas 75247